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Fiduciary Duty Overview for Endowments and Foundations: Integrating Nonprofit Mission Goals into Investment Practices

Colleges, universities, philanthropic foundations and other endowed nonprofit institutions that enjoy tax exemptions because of their social benefit purposes are increasingly examining how endowment fund investment practices can be aligned with the institution's mission, values and goals.[1] A range of stakeholders, including students, staff, alumni, donors and the general public, have begun to call on these nonprofit institutions to direct endowment assets toward investments that offer competitive returns and benefit society while moving assets away from investments that undermine institutional mission or risk harming society.This overview is intended to provide investment fiduciaries with a summary of how fiduciary duties apply to mission-aligned investing, such as strategies that incorporate material environmental, social and governance ("ESG") factors into investment analysis. It shows that prudent adoption of mission-aligned investment techniques can be consistent with fiduciary duty.

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Fiduciary Duties of Endowment Investors

The Uniform Prudent Management of Institutional Funds Act ("UPMIFA") and the Uniform Prudent Investor Act ("UPIA") generally govern endowment investments. They contain the following guidance for endowment fiduciaries.

- Under these two Acts:
  - The standards for managing institutional funds apply whether a charitable organization is organized as a trust, a nonprofit corporation or another entity.
  - The fiduciary should consider the charitable purposes of the institution and the fund when making investment decisions.
  - The fiduciary should provide instructions to investment managers that are consistent with the purposes of the institution and fund, and must monitor the managers' compliance.
- Fiduciaries must act in good faith to manage investments with the care that an ordinarily prudent person in a similar position would exercise under similar

circumstances, but not as a mindless copycat.

- Legal obligations for investment of fund assets include, among others, the duty to:
    - manage associated risk exposures to the fund and to the endowment's goals;
    - diversify investments, except when prudent not to diversify;
    - consider economic conditions;
    - investigate and verify facts relevant to investments;
    - comply with tax requirements;
    - incur only reasonable and appropriate costs; and
    - consider an asset's special relationship with or value to charitable purposes.
- A duty of loyalty applies, which requires investments to be managed to serve the interests of the entity's charitable purpose and to do so with impartiality between current and future obligations.
- Fiduciaries have a duty of obedience to the endowed institution's mission, which requires use of investment practices that serve its charitable purposes and applies to both program and investment activities.
- Prudent investment practices evolve as facts and circumstances change. For example:
    - Many investors that used ethics-based screens have moved to integration of material ESG factors.
    - The prudent investor standard encourages adoption of new investment and risk management knowledge.
    - Investors are responding to research, which has demonstrated that integration of ESG factors into investment practices can be an effective investment strategy that does not require giving up returns.
- Endowment best practice governance and investment policies should reflect the entity's mission.
    - Mission goals can be integrated into strategy, requests for proposals,

contracts, compensation, proxy voting, portfolio company engagement and monitoring of investment service providers.

- Investment committee members should include representatives with mission expertise, skill set diversity and sustainable long-term investment practices knowledge.
- Best practice reports to stakeholders should address how the institution's mission is being integrated into its investment practices.

Conclusion

Endowment fiduciaries should be attentive to the evolution of the investment industry knowledge base and to changes in the environment, economy and society, which can be material to short- or long-term investment risks and opportunities. There is a growing body of research, with corresponding investment practice options, that offer new opportunities to pursue sustainable and mission-aligned investment without sacrificing results.

[2]

Fiduciary duty principles and recent regulatory guidance encourage endowment trustees and managers to respond to these developments through a prudent process that focuses on better aligning investment practices with their nonprofit institution's goals and mission.

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[1]
For example, the following University of Wisconsin - Madison mission statement excerpt is typical for universities. "The primary purpose of the University of Wisconsin–Madison is to provide a learning environment in which faculty, staff and students can discover, examine critically, preserve and transmit the knowledge, wisdom and values that will help ensure the survival of this and future generations and improve the quality of life for all."

[2]
For additional information, see http://www.intentionalendowments.org/the_business_case_for_esg.

[3]

Recent regulatory support of mission-aligned investment practices and the integration of material ESG factors into investment analyses include Federal Department of Labor ERISA Interpretive Bulletins 2015-01 and 2016-01, and IRS Notice 2015-62.